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PLR-116814-07

Date:

October 30, 2007

LEGEND:

Association =

State =

Statute A =

Statute B =

Authority I =

Authority II =

Dear :

This is in response to a letter dated March 19, 2007, and subsequent correspondence submitted by Association, requesting a ruling that the income of Association is excludable from gross income under section 115(1) of the Internal Revenue Code (Code).

FACTS

Association has been organized as a nonprofit corporation under State Statute A and is comprised of local subdivisions of the State and agencies of State subdivisions. Association's purpose is to identify, serve, and promote the needs and interests of its members and the inhabitants of the State regarding the development, management, distribution, and treatment of the State's water resources. To accomplish this purpose,

Association distributes books, magazines and other printed material, organizes and conducts meetings, programs, conferences and seminars, and proposes and advocates local, state and federal policies pertaining to the use of water resources.

Association's governing documents consist of Articles of Incorporation and Bylaws. According to the Bylaws, Association is governed by a board of directors. The board currently consists of voting and non-voting directors. Association's membership consists of geographical regions. The members of each region elect a chair and vice chair. The voting members of Association's board of directors include the president and vice president of Association, the chair and vice chair of each region, the chair of each of eight standing committees and the past presidents of Association. All directors must be employees or elected officials of one of the members of Association.

Membership in Association is limited to entities that control, treat, develop, acquire, use or supply water for any purpose for inhabitants or lands within State, or that are involved in the protection, drainage or reclamation of lands within State. The Bylaws expressly provide that no organization other than a state, a political subdivision of a state or an entity the income of which is excluded from income under section 115 of the Code may be a member of Association. Members are entitled to vote and participate in the decision making and governance of Association.

Association is operated as a nonprofit organization. Its income comes primarily from annual membership dues and from conferences and seminars. All funds are to be used for the exclusive benefit of Association's members. No income of Association inures to the benefit of a private party. Upon dissolution of Association, after all liabilities and expenses are paid, the remaining assets will be distributed to its members.

With assistance from Association, its members formed Authority I, which provides risk-sharing pools to meet the needs of the members for property, liability, and workers' compensation coverage at a lower cost than commercial insurance. At the end of each coverage year, any excess funds and investment income are returned to Association's members, rather than being retained as profit. Authority I is a joint powers authority under Statute B that is recognized as a special district in State. Although formed with the Association's assistance, Authority I is separately governed and operates independently from the Association for the benefit of government entities. Authority I's joint powers agreement provides that a water agency must be a member of Association in order to receive coverage through it.

Association also provides certain employee benefits to its members and certain non-member water companies. The coverage is provided through Authority II which, like Authority I, is a state joint powers authority. Authority II maintains an unfunded plan that holds monies in custodial accounts. Upon termination of Authority II, any funds remaining in the accounts will be distributed to the entities that participated in Authority

II's benefit plans for the twelve months preceding dissolution. To minimize the cost of providing coverage, Association also serves as the benefits administrator with respect to Authority II's benefit plans. Association represents that any private or semi-private entities will be eliminated from participation in the benefits for which Authority serves as benefits administrator. Association provides under penalties of perjury that no organization other than a state, a political subdivision of a state or an entity the income of which is excluded from income under section 115 of the Code will receive benefits through its service as benefits administrator to Authority II.

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from the exercise of an essential governmental function and accruing to a state or a political subdivision of a state.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from a fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its political subdivisions, is excludable from gross income under section 115. The ruling explains that the investment of positive cash balances by a state or political subdivision thereof in order to receive yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes or other revenue for use in meeting governmental expenses. In addition, the ruling also provides that because the state and its participating political subdivisions have an unrestricted right to their proportionate share of the investment fund's income, the fund's income accrues to them within the meaning of section 115(1). Rev. Rul. 77-261 points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that income of an organization formed, operated and funded by political subdivisions of a state to pool their casualty risks is excluded from gross income under section 115(1). The ruling also holds that income of such an organization formed to pool risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is excluded under section 115(1) if private interests do not, except for incidental benefits to employees of the participating state and political subdivisions, participate in or benefit from the organizations.

By assisting local governments to provide for the cost effective acquisition, treatment, and distribution of water to the inhabitants of State, Association performs an essential governmental function within the meaning of §115(1). The income of Association accrues to its members, all of which are states, political subdivisions of a state or entities the income of which is excludable from gross income under §115(1).

The income of Association will not accrue to private parties, other than incidentally, as reasonable compensation for providing goods and services. Upon the dissolution of Association, its remaining funds will be distributed to its members.

Based on the information and representations submitted by Association, we hold that the income of Association will be derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of §115(1). Accordingly, Association's income will be excludable from gross income under §115(1) of the Code.

RULINGS

Upon termination of participation of any private or semi-private entities in Association II's benefit plans administered by Association, as described above, the income of Association will be excludable from gross income under §115(1) of the Code.

Except as otherwise specifically provided, no opinion is expressed on the federal tax consequences of any particular transaction.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representatives.

Sincerely,

SYLVIA F. HUNT
Assistant Chief
Exempt Organizations Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter
Copy for § 6110 purposes

cc: